Economic Head Fake

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Anyone paying attention to investment markets over the last month discovered the power of Fed-speak. All it took was mention of possible easing off the Fed's mortgage purchase program, and interest rates rose measurably. Just about every investment market and asset class contracted in value, a unique circumstance since some markets and asset classes are normally countercyclical to others.

There really should have been little surprise to the market's emotional reaction to the Bernanke-slip. People have been saying for months, some even years, that too much easy money from the Fed was going to lead to more investment bubbles, that conservative savers were getting killed with low interest rates and that the Fed's stimulus effort was sending false price signals to the market.

Many argue that the Fed's money printing/velocity of capital managing exercises distort the true price/value of things. The Fed getting out of the way of the market would supposedly allow more natural price/value clarity to occur, creating a more efficient economy. The common perspective seems to be that market participants need true price/value signals to ensure the productivity of economic decision-making.

It really is a great surprise that so many people have been calling for the Fed to remove its influence so that the economy can operate more efficiently. Have we not for decades been in a market heavily influenced by some combination of monetary, fiscal and regulatory policy?

What would the economy have looked like between 2002 and 2008 without massive government stimulus? Government intervention led to a dangerous real estate bubble, even though the majority of people thought we were in an ordinary economic recovery. Some of the brightest economic minds even suggested we had conquered the business cycle because of our deft ability to manage the economy.

What would the economy have looked like in the 1990s without the deregulation of numerous industries, including electric power, natural gas, telecommunications and financial services? How easy it is to forget that deregulation in power and natural gas eventually led to the Enron bust, deregulation in telecommunications led to the Global Crossing fiasco, and deregulation in financial services almost led to the collapse of the global economic system.

Where is this natural price/value clarity when for at least the last two decades, government policy has significantly influenced the economy?

Government by its nature is going to distort the true price/value of everything. So when economists, investors and investment managers moan and whine about the Fed disrupting organic economic activity, one has to wonder what these experts have been paying attention to.

In sports, a well executed head fake causes one's opponent to believe the play is headed in a certain direction, when it is actually headed in another. How appropriate this seems today when considering the economy and the investment market's reactions to the recent Bernanke-slip.

So many investors and economists were waiting for interest rates to rise that even the hint they might caused them to do so significantly. Now people must be asking, how high will rates eventually go, and for how long will they continue an upward trajectory? The answer could very well be that they have already moved much farther than appropriate for the circumstances.

Market reaction to Bernanke's comment was so great and disturbing that he recently made very strong assurances the Fed was committed to keeping interest rates low until the employment market improves considerably. But what does this mean? When Bernanke talks about the employment market improving considerably, what measure is he using?

The documented benchmark that will supposedly change Fed policy is unemployment reaching 6.5%, a bit more than a full percentage point lower than it is today. But would achieving 6.5% unemployment get us to a comfortable economic position? So long as the details behind employment remain consistent with the current market, the answer should be a resounding, NO! You see, a great number of the jobs we have been creating since the 2008-2009 recession are not highly valuable, economically stimulating or indicative of economic strength.

How many people know that when the Bureau of Labor Statistic reports job creation each month, temporary jobs are included in that figure? That's right, when those job creation numbers are reported temporary jobs get counted just as if they were a permanent job.

Of course, we would feel great to have a temporary job over no job at all, but there should be little celebrating for getting a job that could go away tomorrow. According to the BLS, one-fifth of all the jobs created since the 2008-2009 recession are temporary jobs. According to the American Staffing Association, the percentage has likely been higher. And according to the Labor Department, at no time in the history of our economy have we had this many temporary jobs.

Historically, when temporary jobs would grow post-recession, it was an indication that permanent job growth would soon follow. But that world is now long gone. Temporary employment today is growing because employers have figured out it is better for their bottom line to shift as much labor as possible to variable cost, meaning less permanent employment and more temporary, contract or project employment.

And since Obamacare forces companies to provide health insurance to their full time employees, what can we expect employers to do? Are they going to hire more permanent or more temporary workers?

Beyond the growth of temporary employment, the National Employment Law Project reports that lower-wage occupations constituted 21% of the last recession's job losses, but fully 58% of recovery job growth. Now that's some super charged economy, right?

The nature of work and jobs is going through a very dramatic change that does not point to higher wages or increased benefits. And since wages are required for consumption, which supposedly represents about 70% of our economy, does it matter that we get to 6.5% unemployment or are the details behind that figure much more important?

The end story would seem to be that our current economic "strength" may be nothing but a head fake. We do not have an economy creating enough well paying jobs to suggest we are firmly planted in a world that no longer requires the Fed or other government support. Remember, we are still struggling to get GDP growth above 2%, even with annual government stimulus well past $1 trillion dollars.

The expected rise of interest rates is likely another head fake. Imagine a rising cost of capital in an already very weak economy. Imagine a rising cost of capital in a way over leveraged, developed market sovereign debt environment. Measurably higher interest rates just cannot happen without meaningful economic pain.

Organic economy is about the production and trade of goods and services, but today's economy is much more influenced by government policy. Removing government stimulus from the market would certainly return us to a more organic economic state, but doing so in any economy that has for decades been dominated by, and become dependent on government stimulus is like asking a long time heroin addict to go cold turkey.

There is no returning to more efficient price/value clarity any time soon. Too much government infrastructure has been embedded into economic activity. There will only be the continuing effort by government to "fix" what mostly government had previously broken.

We are stuck with what we have, so odds seem very high that significant monetary, fiscal and regulatory stimulus will continue infinitum, until it no longer can. That day of reckoning is not predictable because the power of self-preservation will cause us to say, change, lie, steal and do anything and everything to forestall it happening.

The new normal is not just alive and kicking, but still under development. Let's not forget how smart and successful we felt in the mid-2000s.

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